



**DEFENSE LOGISTICS AGENCY
DEFENSE CONTRACT MANAGEMENT COMMAND
8725 JOHN J. KINGMAN ROAD, SUITE 2533
FT. BELVOIR, VIRGINIA 22060-6221**



IN REPLY
REFER TO

AQOK

May 9, 1996

**MEMORANDUM FOR COMMANDERS, DEFENSE CONTRACT MANAGEMENT
DISTRICTS**

**SUBJECT: DCMC Policy Letter No. 96-08, External Restructuring Costs Under Defense
Contracts**

This letter is directive in nature and expires when its content is incorporated into DLAD 5000.4,
Contract Administration.

On April 18, 1996, the Director, Defense Procurement, issued a memorandum concerning the allowability of restructuring costs under Defense contracts (**Attachment 1**). The memorandum contains a final Defense Federal Acquisition Regulation Supplement (**DFARS**) rule (effective April 18, 1996) which provides policies and procedures for allowing appropriate contractor costs which involve external restructuring activities. The final rule implements Section 818 of the National Defense Authorization Act for Fiscal Year 1995 (**Public Law 103-337**). Section 818 restricts the Department of Defense (**DoD**) from paying restructuring costs associated with a business combination until an Assistant Secretary of Defense level official certifies that projections of future cost savings have been audited and should result in overall reduced costs for **DoD**.

The final rule differs from the interim rule in that it: (a) clarifies definitions of restructuring activity, restructuring costs, and restructuring savings; (b) excludes business combinations with less than \$2.5 million in restructuring costs for DoD from audit, review, and certification requirements; (c) limits the certification requirement to restructuring activities normally initiated within three years of a business combination; (d) clarifies that the net savings determination is based on a cumulative costs/savings for all projects rather than a project by project basis; (e) eliminates the requirement for a Memorandum of Understanding (**MOU**) between DoD and the contractor; and (f) requires the contracting officer to include a repricing clause in each fixed-priced action if restructuring costs are included in pricing rates prior to certification.

The final rule clarifies the definition of restructuring activities to exclude those costs associated with routine or other ordinary activities that would have otherwise been incurred. This includes compensation that would have been paid to contractor employees even if the business combination had not occurred. Consequently, such costs should not be suspended from contract billings or amortized as restructuring costs. Finally, even though the Administrative Contracting Officer (**ACO**) is no longer required to negotiate a **MOU**, the ACO must still negotiate an advance agreement establishing a cost ceiling for restructuring projects and, when necessary, a cost amortization schedule.



Attachment 2 provides a new Defense Logistics Agency Directive 5000.4 (One Book) chapter concerning contractor **restructuring** associated with a business combination. This supersedes all previous DCMC policy concerning this **subject**. Please ensure this information is disseminated to your ACOs. Any questions concerning this matter should be addressed to Mr. William Hill, Overhead Center of Excellence, at DSN 427-3388 or (703) 767-3388.

A handwritten signature in black ink, appearing to read "Robert W. Drewes", with a stylized, cursive script.

ROBERT W. DREWES
Major General, USAF
Commander

Attachments

cc:

Defense Corporate Executives



ACQUISITION AND
TECHNOLOGY
DP (DAR)

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON DC 20301-3000

April 18, 1996



In reply refer to
DFARS Case: 94-D316
D. L. 96-006

MEMORANDUM FOR DIRECTORS OF DEFENSE AGENCIES
DEPUTY FOR ACQUISITION AND BUSINESS MANAGEMENT,
ASN(RD&A)/ABM
DEPUTY ASSISTANT SECRETARY OF THE AIR FORCE
(CONTRACTING), SAF/AQC
DIRECTOR, PROCUREMENT POLICY, ASA(RD&A)/SARD-PP
DEPUTY DIRECTOR (ACQUISITION), DEFENSE LOGISTICS AGENCY

SUBJECT: Restructuring Costs Under Defense Contracts

We have amended Parts 231 and 242 of the Defense Federal Acquisition Regulation Supplement (DFARS) to implement Section 818 of the FY 1995 Defense Authorization Act (Pub. L. 103-337). Section 818 restricts DoD from reimbursing external restructuring costs associated with a business combination undertaken by a defense contractor unless certain conditions are met.

The attached DFARS rule revises and finalizes the interim rule which was published as Item XXIII of DAC 91-7.

This final DFARS rule is effective immediately and will be published in a future Defense Acquisition Circular.

Eleanor R. Spector
Director, Defense Procurement

Attachment

cc : DSMC, Ft. Belvoir



attachment 1

DFARS CASE 94-D316, RESTRUCTURING COSTS UNDER DEFENSE CONTRACTS
FINAL RULE

PART 231--CONTRACT COST PRINCIPLES AND PROCEDURES

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SUBPART 231.2--CONTRACTS WITH COMMERCIAL ORGANIZATIONS

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231.205-70 [External] [r]Restructuring costs.

(a) *Scope.*

This subsection prescribes policies and procedures for allowing ~~appropriate~~ contractor **[external]** restructuring costs when **[net savings]** ~~allowing such costs~~ would result ~~in net savings~~ for DoD. This subsection also implements Section 818 of the National Defense Authorization Act for Fiscal Year 1995 (Public Law 103-337).

(b) *Definitions.*

As used in this subsection:

- (1) "Business combination" means a transaction whereby assets or operations of two **[or more]** ~~previously~~ separate companies **[not previously under common ownership or control]** are combined, whether by merger, acquisition, or sale/purchase of assets.
- (2) "External restructuring activities" means restructuring activities occurring after a business combination that **[affect the operations of]** ~~involve facilities or workforce from both of the previously separate~~ companies ~~not previously under common ownership or control~~. They do not include restructuring activities occurring after a business combination that affect the operations of only one of the **companies** not previously under **common** ownership or **control**, or, when there has been no business **combination**, restructuring activities undertaken within one **company**. External **restructuring** activities are a direct outgrowth of ~~a~~ business combination. They normally will be initiated within 3 years of the business **combination**.]
- ~~(3) "Internal restructuring activities" means restructuring activities occurring after a business combination that~~

~~involve facilities or workforce from only one of the previously separate companies, or, when there has been no business combination, restructuring activities undertaken within one company.~~

- (3) "Restructuring activities" means nonroutine, nonrecurring, or extraordinary activities **[to combine]** ~~associated with the reduction of~~ facilities **[, operations,]** or workforce, ~~or consolidation of facilities or operations (including disposal or abandonment undertaken to effect such consolidation), in an effort to~~ **[in order to eliminate redundant capabilities,]** improve future operations **[,]** and reduce overall costs. Restructuring activities do not include routine or ongoing repositionings and redeployments of a contractor's productive facilities or workforce (e.g., normal plant rearrangement or employee relocation)**[, nor do they include other routine or ordinary activities charged as indirect costs that would otherwise have been incurred (e.g., planning and analysis, contract administration and oversight, or recurring financial and administrative support)]**.
- (4) "Restructuring costs" means the costs, including both direct and indirect, **[of]** ~~associated with~~ restructuring activities. Restructuring costs that may be allowed include, but are not limited to, severance pay for employees, early retirement incentive payments for employees, employee retraining costs, relocation expense for retained employees, and relocation and rearrangement of plant and equipment. **[For purposes of this definition, if restructuring costs associated with external restructuring activities allocated to DoD contracts are less than \$2.5 million, the costs shall not be subject to the audit, review, and certification requirements of 231.205-70(c) (1); instead, the normal rules for determining cost allowability in accordance with FAR Part 31 shall apply.]**
- (5) "Restructuring savings" means cost reductions, including both direct and indirect cost reductions, ~~that are directly associated with or~~ result directly from restructuring activities. Reassignments of cost to future periods are not restructuring savings.

(c) Limitations on cost allowability.

- (1) Restructuring costs associated with external restructuring activities shall not be allowed unless--

- (i) Such costs are allowable in accordance with FAR Part 31 and DFARS Part 231;
 - (ii) An audit of projected restructuring costs and restructuring savings is performed;
 - (iii) The cognizant administrative contracting officer (ACO) reviews the audit report and the projected costs and projected savings, determines that overall reduced costs should result for DoD, and negotiates an advance agreement in accordance with 231.205-70(d)(8); and
 - (iv) A certification is made by the Under Secretary of Defense (Acquisition & Technology), his Principal Deputy or designee (in all cases, an individual appointed by the President and confirmed by the Senate), that projections of future restructuring savings resulting for DoD from the business combination are based on audited cost data and should result in overall reduced costs for DoD.
- (2) The [audit, review, and] certification required by 231.205-70(c)(1)(iv) shall not apply to any business combination for which payments for restructuring costs were made before August 15, 1994, or for which the cognizant ACO executed an advance agreement establishing cost ceilings based on audit/negotiation of detailed cost proposals for individual restructuring projects before August 15, 1994.
- ~~(3) Costs that may be incurred after a business combination but are not allowed in accordance with FAR Part 31 and DFARS Part 231 include, but are not limited to:~~
- ~~(i) Incorporation fees; costs of attorneys, accountants, brokers, promoters, organizers, management consultants, and investment counselors (see FAR 31.205-27).~~
 - ~~(ii) The cost of any change in the contractor's financial structure (see FAR 31.205-27).~~
 - ~~(iii) Interest or other cost of borrowing to finance the acquisition or merger (however represented) (see FAR 31.205-20).~~

- ~~(iv) When the purchase method of accounting for a business combination is used, increased depreciation, amortization, or cost of money attributable to increases in the book value of plant, equipment, and other tangible assets of the acquired company above the amount that would have been allowed if the business combination had not taken place (see FAR 31.205-52).~~
- ~~(v) Any costs for amortization, expensing, write-off, or write down of goodwill (however represented) (see FAR 31.205-49).~~
- ~~(vi) Payments to employees of special compensation in excess of the contractor's normal severance pay practice if their employment terminates following a change in the management control over, or ownership of, the company or a substantial portion of its assets (see FAR 31.205-6(1)(1)).~~
- ~~(vii) Payments to employees of special compensation which is contingent upon the employee remaining with the contractor for a specified period of time following a change in the management control over, or ownership of, the company or a substantial portion of its assets (see FAR 31.205-6(1)(2)).~~

(d) *Procedures and ACO responsibilities.*

As soon as it is known that the contractor will incur restructuring costs ~~associated with~~ **[for]** external restructuring activities, the cognizant ACO shall:

- [(1) Promptly execute a novation agreement, if one is required, in accordance with FAR Subpart 42.12 and DFARS Subpart 242.12 and include the provision at DFARS 242.1204(e).]**
- [(2)± Direct the contractor to segregate restructuring costs and to suspend these amounts from any billings, final contract price settlements, and overhead settlements until the certification in (c)(1)(iv) is obtained.**
- [(3)± Require the contractor to submit an overall plan of restructuring activities and an adequately supported proposal for planned restructuring**

projects. The proposal must include a ~~detailed~~ breakout by year by cost element, showing the projected restructuring costs, ~~both direct and indirect~~, and projected restructuring savings, ~~both direct and indirect~~.

- ~~(3) Negotiate a Memorandum of Understanding with the contractor setting forth, at a minimum, the types and treatments of restructuring costs and the methodology to be used to demonstrate reduced costs to DoD.~~
- (4) Notify major buying activities of contractor restructuring actions and inform them about any potential monetary impacts on major weapons programs, when known.
- (5) Upon receipt of the contractor's proposal, ~~immediately~~ **[as soon as practicable,]** adjust forward pricing rates to reflect the impact of projected restructuring savings. **[If restructuring costs are included in forward pricing rates prior to]** ~~Pending~~ execution of an advance agreement in accordance with 231.205-70(d)(8), **[the contracting officer shall include]** ~~restructuring costs may be included in forward pricing rates~~ if a repricing clause ~~is included~~ in each fixed-price action that is priced based on the rates. The repricing clause must provide for a downward price adjustment to remove restructuring costs if the certification required by 231.205-70(c)(1)(iv) is not obtained.
- (6) Upon receipt of the contractor's proposal, immediately request an audit review of the contractor's proposal.
- (7) Upon receipt of the audit report, determine if restructuring savings will exceed restructuring costs on a present value basis.
- (8) Negotiate an advance agreement with the contractor setting forth, at a minimum, **[a cumulative]** cost ceiling ~~[for] amounts on~~ restructuring projects and, when necessary, a cost amortization schedule. **[The] C[c]ost ceilings** may not exceed the amount of projected restructuring savings on a present value basis. The advance agreement shall not be

executed until the certification required by 231.205-70(c)(1)(iv) is obtained.

- (9) Submit to the Director of Defense Procurement, Office of the Under Secretary of Defense (Acquisition & Technology), ATTN: OUSD(A&T)DP/CPF, a recommendation for certification of net benefit. Include the information described in 231.205-70(e).

(e) Information needed to obtain certification of net benefit.

- (1) The novation agreement (if one is required).
- (2) The contractor's restructuring proposal.
- (3) The proposed advance agreement.
- (4) The audit report.
- (5) Any other pertinent information.
- (6) The cognizant ACO's recommendation for certification. This recommendation must clearly indicate that contractor projections of future cost savings resulting for DoD from the business combination are based on audited cost data and should result in overall reduced costs for the Department.

SUBPART 242.12--NOVATION AND CHANGE-OF-M AGREEMENTS

* * * * *

242.1204 Agreement to recognize a successor in interest (novation agreement).

(e) When a novation agreement is required and the transferee intends to incur restructuring costs as defined at 231.205-70, the cognizant contracting officer shall include the following provision as paragraph (b)(7) of the novation agreement instead of the paragraph (b)(7) provided in the sample format at FAR 42.1204(e):

"(7)(i) Except as set forth in subparagraph (7)(ii) below, the Transferor and the Transferee agree that the Government is not obligated to pay or reimburse either of them for, or otherwise give effect to, any costs, taxes, or other expenses, or any related increases, directly or indirectly arising out of or resulting from the transfer or this Agreement, other than those that the Government in the absence of this transfer or Agreement would have been obligated to pay or reimburse under the terms of the contracts.

(ii) The Government recognizes that restructuring by the Transferee incidental to the acquisition/merger may be in the best interests of the Government. Restructuring costs that are allowable under Part 31 of the Federal Acquisition Regulation (FAR) or Part 231 of the Defense Federal Acquisition Regulation Supplement (DFARS) may be reimbursed under flexibly-priced novated contracts, provided the Transferee demonstrates that the restructuring will reduce overall costs to the Department of Defense (DoD) [(and to the National Aeronautics and Space Administration (NASA), where there is a mix of DoD and NASA contracts)] and/or the National Aeronautics and Space Administration (NASA), and the requirements included in DFARS 231.205-70 are met. ~~These costs and the contracting parties' responsibilities shall be addressed in a Memorandum of Understanding to be negotiated between the cognizant contracting officer and the Transferee. The Memorandum of Understanding will specify the types and treatment of restructuring costs and the methodology to be used to demonstrate reduced costs to DoD and/or NASA.~~ Restructuring costs shall not be allowed on novated contracts unless there is an audit of the restructuring proposal; a determination by the contracting officer of overall reduced costs to DoD/NASA; and an Advance Agreement setting forth [a cumulative] cost ceiling [for] ~~amounts on~~ restructuring projects and the period to which such costs shall be assigned."

A REFERENCES:

1. **FAR 42.12**, Novation and Change of Name Agreements
2. DFARS 242.12, Novation and Change of Name Agreements
3. DFARS 231.205-70, External Restructuring Costs

B. GENERAL:

Section 818 of the National Defense Authorization Act for Fiscal Year 1995 (Public Law 103-337) restricts the Department of Defense (DoD) from reimbursing restructuring costs associated with a business combination undertaken by a defense contractor unless certain conditions are met. In particular, restructuring costs associated with external restructuring activities shall not be allowed unless:

- a. Such costs are allowable in accordance with FAR Part 31 and DFARS Part 231;
- b. An audit of projected restructuring costs and restructuring savings is performed;
- c. The cognizant administrative contracting officer (ACO) reviews the audit report and the projected costs and projected savings, determines that overall reduced costs should result for DoD, and negotiates an advance agreement, and
- d. A certification is made by the Under Secretary of Defense (Acquisition & Technology), his Principle Deputy or designee, that projections of future restructuring savings resulting for DoD from the business combination are based on audited data and should result in overall reduced cost for DoD.

The audit, review and certification requirements in DFARS 231.205-70 apply only to restructuring activities that meet all of the following criteria.

- a. Occur after a business combination.
- b. Affect the operations of one or more companies not previously under common ownership or control (e.g., the newly acquired corporation).
- c. Normally initiated within three years of the business combination. If the contractor has made a good faith effort to restructure within three years of the business combination, then any new and unexpected restructuring activities that occur after three years do not require an audit, review or certification.
- d. Result in costs allocable to DoD contracts of \$2.5 million or more. The \$2.5 million criterion is the absolute dollar amount that can be allocated to existing DoD flexibly priced contracts and future negotiated DoD contracts (including fixed-priced contracts) without having to fulfill the audit, review and certification requirement. Also, \$2.5 million is the aggregate amount of all restructuring costs following a business combination. The ACO shall maintain supporting documentation why an audit, review and certification was not required.

Attachment 2

C. PROCESS NARRATIVE:

1. PROMPTLY EXECUTE A NOVATION, IF ONE IS REQUIRED

The ACO of selling company shall promptly execute the novation agreement. See Part V Chapter 7: Novation and Change of Name Agreements.

2. SEGREGATE AND SUSPEND RESTRUCTURING COSTS

Following the business combination, the ACO of the acquiring company shall request the contractor if it plans any restructuring activities. If restructuring activities are planned, the ACO of the acquiring company shall direct the contractor to segregate restructuring costs and to suspend these amounts from any billings, final contract price settlements, and overhead settlements until certification is received.

3. OBTAIN RESTRUCTURING PLAN AND PROPOSAL

a. The ACO shall request the contractor to provide an overall plan of restructuring activities and an adequately supported proposal for planned restructuring projects. The ACO should request the contractor to use the guidelines in paragraph d. below to prepare its restructuring proposal in order to streamline the certification process. However, these are only guidelines. Additional supporting details may be necessary based on the ACO's assessment of the contractor's capability to demonstrate that projected restructuring savings exceed estimated costs. It is also important to point out that restructuring proposal preparation is the responsibility of the contractor and not the ACO.

b. Normally, the contractor should be required to provide additional supporting details in instances where the estimating system or accounting system is inadequate, or where project savings are projected to be about the same as restructuring costs. In all cases, the ACO should balance the need to expedite the process with the requirements for a restructuring proposal. However, we recognize that contractor proposal development timeframes may differ depending on the complexity of the contractor's restructuring effort. To streamline the process, the ACO should work together with both contractor personnel and Defense Contract Audit Agency (DCAA) auditors to reduce the cycle time for contractor proposal preparation and Government audit by establishing goals and timeframes, committing resources, and resolving issues.

c. A cycle time reduction or integrated product team approach to preparing and reviewing restructuring proposals is highly recommended. A cycle time reduction approach involves early identification and resolution of any problems that occur during the contractor's proposal preparation and the Government audit process. This requires establishment of a team consisting of contractor representatives who develop the proposal (restructuring proposal preparation is the sole responsibility of the contractor), auditors who review the proposal (parts may be reviewed as completed), and the cognizant ACO who oversees an issue resolution process. Issues should be addressed as soon as they are discovered. Up-front communication, coordination, and planning are essential. The team should meet at an early stage to share plans, discuss information needs, assess risk and level of proposal detail, and establish goals, milestones, and timeframes.

d. The following outline provides guidelines for a contractor's restructuring proposal.

(1) PROJECT OVERVIEW

(a) Statement of Work/Period of Performance. Outlines the proposed restructuring actions and the anticipated span time. Included would be the locations and facilities involved and the interrelationship to other projects/segments as applicable. Establishes the rationale for treating the project as a stand-alone project versus consolidation with other projects. Establishes the rationale for considering the project as external versus normal internal restructuring.

(b) Cost and Savings Summary. Summary level by year and element. Includes breakout for Net Present Value (NPV)/DoD share. Demonstrates relationship of cost and savings.

(c) Project Management. Outlines how the project will be managed and the points of contact from an operational and audit perspective.

(d) Cost Collection/Allocation. Establishes the types of cost to be collected, the proposed amortization period, the causal/beneficial relationships, and method(s) of allocation. Also, demonstrates the method for suspending costs from billings pending certification. The amortization period for restructuring costs should be the estimated benefit life (number of years used to compute estimated reduced costs). Recognizing that the date at which future costs reductions become nonexistent or negligible is difficult to determine (or in some cases indeterminate), as a practical solution, the amortization period normally should not exceed five years. Although amortization is the appropriate accounting treatment for nonroutine, nonrecurring, or extraordinary restructuring activities, ACOs may, on an exceptional basis, accept current period costing when they, in consultation with the cognizant auditors, determine it to be in the best interest of the Government.

(e) Team Identification and Certification Milestones. Identifies the team and its plan for completing the certification process, including target dates and responsibilities. The team should be comprised of DCMC, DCAA, and contractor personnel. The team should establish goals and time frames to reduce cycle time.

(f) Relationship to Forward Pricing. Presents the plan for interim update to existing forward pricing and the agreed upon schedule for detailed integration. Outlines the appropriate rates to be adjusted based on the relationship of cost and savings to individual rates or to the business unit as a whole. Further definitization, as it becomes known, will be incorporated into forward pricing to reflect subsequent updates and/or changes.

(g) Special Conditions. Includes reference to any overlying corporate agreements and/or local Memorandum of Understanding provisions.

(2) COST

“Restructuring costs that may be allowed include, but are not limited to, severance pay for employees, early retirement incentive payments for employees, employee retraining costs, relocation expenses for retained employees, and relocation and rearrangement of plant and equipment .” (DFARS 231.205-70)

(a) Cost Summary Schedule. Outlines each element of cost by year and origin. Indicates if based on history or estimating technique. Cross-referenced to supporting Basis of Estimate (BOE). Includes “pointer” to applicable forward pricing pool or base. NPV and DoD share factors included and supported. Escalation assumptions documented.

(b) Cost Element BOEs. Contains the BOE for each cost element included in the above schedule. Based on best available data at the time, with appropriate level of detail as agreed upon by the team. At a minimum, an individual cost element must be traceable to a final rate pool or base.

NOTE: It is recognized that each restructuring project will be unique in regard to size, complexity, and maturity. It is therefore imperative that the team establish the BOE approach that is appropriate under the circumstances and with due consideration given to risk, materiality, and process efficiency.

The following examples represent types of data that could be used to support costs in a proposal BOE. These costs would normally be identified to the appropriate expense pools.

(1) Severance Pay: This element of cost could be estimated based on the expected headcount reduction at the segment level times the historical severance pay per employee. Adjustments may be required for different benefits of merging companies. Definitization, as it becomes known, will be incorporated into forward pricing to reflect subsequent updates and/or changes.

(2) Early Retirement Incentives. This element of cost could be estimated based on the expected number of early retirements at the segment level times the historical (or announced) incentive values. Definitization, as it becomes known, will be incorporated into forward pricing to reflect subsequent updates and/or changes.

(3) Employee Retraining Costs. This element of cost is more difficult to estimate due to probable lack of a historical basis. A proposal will at least include an estimate of the number of personnel to be retrained and the type of retraining required. Surrogate measures of required “per head” retraining hours may be available from industrial engineering standards and/or industry literature. Another possibility could be experience from Government-sponsored defense industry retraining programs. The value of the retraining hours could be valued at a plant-wide rate or further subset if so definitized at the time of the proposal. Definitization, as it becomes known, will be incorporated into forward pricing to reflect subsequent updates and/or changes.

(4) Relocation Expense. This element of cost could be estimated based on the number of identified potential relocations times the historical values. Allowable costs could also be established from history, as well as unallowables. Definitization will be incorporated into forward pricing to reflect subsequent updates and/or changes.

(5) Relocation/Rearrangement of Plant and Equipment. This element of cost may be substantial and may be incurred over several years. Types of costs may include writeoffs of capital and leasehold improvements, canceling leases, broker fees, restoration costs, code upgrades, demolition, moving/storage/reinstallation costs, capital improvements, and project management. Due to the significance of the cost, every effort should be made to definitive the facility plans to the maximum extent possible for incorporation into the proposal. Supporting BOEs will most likely be varied in nature and fairly specific to the affected plant and equipment. Based on the foregoing, the team should reach mutual agreement regarding the content and detail of the BOEs before the estimates are prepared. Definitization will be incorporated into forward pricing to reflect subsequent updates and/or changes.

(6) Other Cost Elements. Other cost elements should be supported by BOEs to the extent and detail necessary per agreement of the team.

(3) SAVINGS

“Restructuring savings means cost reductions, including both direct and indirect cost reductions that are directly associated with or result directly from restructuring activities.”
(DFARS 231.205-70)

(a) Savings Summary Schedule. Outlines each element of savings by year and origin. Indicates if based on history or estimating technique. Cross-referenced to supporting BOE. Includes “pointer” to applicable forward pricing pool or base. NPV and DoD share factors included and supported. Escalation assumptions documented.

(b) Savings Element BOEs. Contains the BOE for each savings element included in the above schedule. Based on best available data at the time, with appropriate level of detail as agreed upon by the team. At a minimum, an individual savings element must be traceable to a final rate pool or base.

NOTE: It is recognized that each restructure project will be unique in regard to size, complexity, and maturity. It is therefore imperative that the team establish the BOE approach that is appropriate under the circumstances and with due consideration given to risk, materiality, and process efficiency.

The following examples represent types of data that could be used to support savings in a summary proposal BOE:

(1) Headcount Reductions. This element of savings could be estimated based on the announced target reductions time the average historical (and projected) labor rate,

plus adders, for the affected department, facility, or business unit, based on best available data at the time of the summary proposal preparation. The initial rate impact would have to be estimated and immediately taken to existing forward pricing. Further definitization, as it becomes known, will be incorporated into forward pricing to reflect subsequent updates and/or changes.

(2) Facilities Reductions. This element of savings could be estimated based on the announced square footage reduction times a segment-wide facility rate, or more preferably, based on historical (and projected) costs of identified facilities. The maturity of the facility reduction plan will necessarily dictate the BOE approach. Based on the significance and complexity of these savings initiatives, the team should agree on the BOE approach before the summary proposal is prepared.

The initial rate impact would have to be estimated and immediately taken to existing forward pricing. Further definitization, as it becomes known, will be incorporated into forward pricing to reflect subsequent updates and/or changes.

(3) Other Savings Elements. Other cost elements should be supported by BOEs to the extent and detail necessary per agreement of the team.

4. NOTIFY MAJOR BUYING ACTIVITIES

The ACO shall notify major buying activities of contractor restructuring action and inform them about any potential monetary impacts on major weapon programs. In addition, if restructuring costs are included in forward pricing rates prior to the execution of an advance agreement, the ACO shall notify the procurement contracting officer to include a repricing clause in each fixed-price action that is priced based on the rates. See DFARS 231.205-70(d)(5).

5. ADJUST FORWARD PRICING RATES

As soon as practical after the restructuring proposal is submitted, the ACO shall adjust forward pricing rates to reflect estimated restructuring savings. Such an adjustment is the best evidence of overall reduced costs for DoD as a result of restructuring and greatly facilitates the audit and certification process. In addition, the ACO should continually evaluate and, if necessary, adjust forward pricing rates after proposal submission.

6. REQUEST AN AUDIT OF THE CONTRACTOR'S PROPOSAL

After receiving the contractor's restructuring proposal, the ACO shall request an audit of the proposal.

7. NEGOTIATE AN ADVANCE AGREEMENT WITH THE CONTRACTOR

a. Upon issuance of the DCAA audit report, the ACO shall negotiate an advance agreement which addresses the allowability of contractor restructuring expenditures and the resultant

projected cost savings realized by the Department of Defense. To ensure overall consistency among contractors, paragraph b. provides a sample advance agreement. This format may be slightly modified to allow for individual user requirements.

b. Sample restructuring advance agreement. (Note: numbers shown are for illustrative purposes only.)

ADVANCE AGREEMENT
DIVISION/SEGMENT/GROUP RESTRUCTURING EXPENDITURES
COVERING ACCOUNTING PERIODS 199X THROUGH 199X

In accordance with Federal Acquisition Regulation (FAR) 31.109 and the Department of Defense (DoD) FAR Supplement (DFARS), 231.205-70, this document sets forth an Advance Agreement between the DoD and XYZ Company, City Name, State Name.

WHEREAS, it is in DoD's best interest to encourage XYZ's concentration and restructuring of its missile/aircraft/electronic operations as the defense business declines in order to reduce operating costs and thereby reduce contract costs.

WHEREAS, XYZ Company has effectively demonstrated to DoD, through audited cost data, that its restructuring activities result in overall reduced costs to DoD, XYZ Company and the DoD agree to the following: (NOTE: certification is only required to establish reduced costs to DoD. Consequently, if most of the contracts are non-DoD, indicate DoD costs and savings separately from civilian agency costs and savings.)

a. This Agreement is applicable to direct and indirect restructuring costs allowable on DoD contracts during calendar/fiscal years 199X through 199X. (Note: specify annual period if fiscal year is used.) For purposes of this agreement, allowable direct and indirect restructuring costs associated with XYZ Company's restructuring activities are those defined in DFARS 231.205-70.

b. Restructuring costs resulting from a business combination that are normally unallowable as defined in DFARS 231.205-70 shall not be allowed.

c. Based on the Government's audit of incurred and projected cost data, the parties agree that (1) the Net Present Value (NPV) of DoD's share of total incurred and projected restructuring savings is estimated to be \$91.3 million; (2) the NPV of DoD's share of the total incurred and projected restructuring costs is estimated to be \$77.3 million based on product mix; and (3) such amounts should result in overall reduced costs to DoD.

d. The parties agree that XYZ Company's total restructuring costs shall not exceed the negotiated cost ceiling of \$130.5 million. Of this amount, \$85.0 million is the maximum share of restructuring costs which will be absorbed by DoD. In no case shall the DoD's share of the restructuring costs exceed the DoD's share of savings.

e. Applicable years' depreciation amounts are included in the negotiated ceiling. Remaining years' depreciation is allowable and allocable in accordance with disclosed practices unless otherwise unallowable per provisions of FAR and CAS.

f. A cost/savings amortization schedule of projected cost/savings indicated above is shown below:

<u>Projected Cost/Savings Summary</u>								
(\$M)								
<u>Year:</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>Total</u>
Projected Total Savings:	0.0	28.9	28.9	28.9	28.9	28.9		\$144.5
@ NPV:								120.4
DoD share:								\$ 91.3
Projected Amort. Costs:	2.5	16.0	23.4	22.5	23.0	19.9	8.6	\$115.9
Depreciation: *		.1	.4	.6	.6	.5	.5	2.7
Amort. & Dep @ NPV:								97.0
DoD share:								\$ 77.3

* Includes the applicable years of the total depreciation schedule.

g. The amortized cost targets and depreciation will be used as the basis for (1) initial allocation of estimated implementation costs; (2) establishment of billing rates; and (3) Forward Pricing purposes. Concurrently, the segments' cumulative Forward Pricing Rate Proposals and/or other direct cost factors related to restructuring will be offset by at least an equivalent amount of savings over the period of this Agreement.

h. XYZ Company will maintain separate records identifying direct and indirect restructuring costs allowable on DoD contracts which will be subject to Government audit verification.

i. XYZ Company contracts are defined as those current and future contracts entered into under the name of XYZ Company, missile/aircraft/electronic systems division/segment/group, and former ABC Corporation contracts affected by the Asset Purchase Agreement dated day/month/year, and novated to XYZ Company. For purposes of this Agreement, current firm fixed price contracts will not be modified as a result of the subject restructuring action taken by XYZ Company. However, any future modifications for these firm fixed price contracts shall be covered by the terms of the Agreement.

j. This Agreement establishes no precedent concerning the allowability, allocability or reasonableness of costs incurred by XYZ Company or any of its business divisions/segments/ groups or organizations under control of XYZ Company.

k. This Agreement constitutes Exhibit X to the Novation Agreement between DoD, ABC Corporation, and XYZ Company executed on day/month/year.

l. This Agreement does not constitute an obligation of funds. Recovery of costs pursuant to this Agreement shall be subject to provisions and clauses as set forth in the individual contracts to which this Agreement applies.

FOR XYZ COMPANY

FOR THE DEPARTMENT OF DEFENSE

Name of Company
Representative

Name of Administrative
Contracting Officer

Date

Date

8. SUBMIT CERTIFICATION OF NET BENEFIT

a. DFARS 231.205-70(d)(9) requires the ACO to submit a recommendation for certification of net benefit. Paragraph b. provides an example ACO certification of net benefit.

b. Example ACO certification of net benefit:

RECOMMENDATION FOR CERTIFICATION
NAME OF RESTRUCTURING PROJECT
NAME OF DIVISION/SEGMENT/GROUP

The undersigned hereby certifies that projections of future cost savings resulting for DoD from the facilities consolidation efforts of the contractor segments named herein which followed XYZ Company's combination with division/segment/group of ABC Company are based on audited cost data and should result in overall reduced costs for the Department.

Name of ACO
Title

Date

c. DFARS 231.205-70(e) lists items which must be submitted to the Director of Defense Procurement (DDP) in order to obtain a certification of net benefit from the Office of the Secretary of Defense. In addition to those items required by Section 231.205-70(e), documentation placed at the front of the submission package shall include: (a) an index listing items submitted; (b) a brief narrative description of the restructuring project(s); (c) a summary of restructuring costs and savings (paragraph d. below) and; (d) a coordination from the counsel responsible for reviewing the advance agreement. The ACO's negotiation memorandum should be detailed and thoroughly document and highlight any differences between the ACO and DCAA. All ACO requests for certification of net benefit will be reviewed and boarded at Headquarters, DCMC prior to submission to the DDP. Due to its involvement in the area of contractor restructuring, the ACO should contact the DCMC Overhead Center of Excellence prior to preparing their certification of net benefit submissions. Certification submissions shall be submitted directly to the DCMC Overhead Center of Excellence at the following address:

ATTN: Overhead Center of Excellence (AQOK)
 Defense Logistics Agency
 8725 John J. Kingman Road, STE 2533
 Ft. Belvoir, VA 22060-6221

d. Example restructuring costs and savings summary:

COST AND SAVINGS SUMMARY

PROJECT NAME
 (Millions of Dollars)

									DoD
	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>TOTAL</u>	<u>NPV</u> <u>SHARE</u>
SAVINGS:		28.9	28.9	28.9	28.9	28.9		144.5	120.4 \$ 91.3
<u>COSTS:</u>									
Amortized	2.5	16.0	23.4	22.5	23.0	19.9	8.6	115.9	
Depreciation		0.1	0.4	0.6	0.6	0.5	0.5	<u>2.7</u>	
TOTAL COSTS:								118.6	97.0 \$ <u>77.3</u>
<u>ESTIMATED NET SAVINGS:</u>								25.9	23.4 \$ <u>14.0</u>
<u>NEGOTIATED CEILING FOR RESTRUCTURING COSTS:</u>								130.5	106.7 \$ <u>85.0</u>

PROJECTED NET SAVINGS TO DOD AFTER DEDUCTING

THE NEGOTIATED \$85.0M COST CEILING (\$91.3 - \$85.0):

\$ 6.3

Numbers indicated above should be cross referenced to DCAA audit report and ACO negotiation memorandum.

D. SYNOPSIS OF PROCESS:

1. Certification Process

a. Inputs:

- (1) Request contractor if restructuring activities are planned
- (2) Request contractor to segregate and suspend restructuring costs
- (3) Request contractor for restructuring plan and proposal
- (4) Notify major buying activities of restructuring impacts
- (5) Adjust forward pricing rates
- (6) Request audit of contractor's proposal
- (7) Negotiate advance agreement
- (8) Submit certification of net benefit

b. Outputs:

- (1) Negotiation memorandum
- (2) Recommendation for certification
- (3) Advance agreement

